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Legislative Audit Division

State of Montana

Report to the Legislature

December 1999

Financial Audit

For the Fiscal Year Ended June 30, 1999

Montana State Fund

We performed a financial audit for the fiscal year ended June 30, 1999. This report contains the audited financial statements and accompanying notes for fiscal year 1998-99, with comparative fiscal year 1997-98 amounts. We issued an unqualified opinion on the financial statements. The opinion means the reader may rely on the financial statement information presented.

The current report contains no recommendations to the Fund. The prior report also contained no recommendations.

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FINANCIAL AUDITS

Financial audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office. Financial audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 1999, will be issued by March 31, 2000. Copies of the Single Audit Report, when available, can be obtained by contacting:

Single Audit Coordinator
Office of Budget and Program Planning
State Capitol
Helena MT 59620
Phone (406) 444-3616

Legislative Audit Division
Room 135, State Capitol
PO Box 201705
Helena MT 59620-1705

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Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
James Gillett, Financial-Compliance Audit

December 1999

The Legislative Audit Committee
of the Montana State Legislature:

This is our report on the financial audit of the Montana State Fund for fiscal year 1998-99. The objectives of this financial audit include determining if the financial statements for fiscal year 1998-99 with comparative financial amounts for fiscal year 1997-98 present fairly the Montana State Fund's financial position at June 30, for each fiscal year, and the results of its operation for the fiscal year then ended. We tested compliance with laws that have a direct and material effect on the financial statements.

Montana State Fund is a workers' compensation insurance company established by the State of Montana. It is a nonprofit, independent public corporation that provides Montana employers with an option for workers' compensation and occupational disease insurance. Montana State Fund is governed by a seven-member board of directors appointed by the Governor. State law separates funding sources for claims incurred before July 1, 1990 (Old Fund) and those incurred on or after July 1, 1990 (New Fund).

Montana State Fund management must set premium rates at amounts sufficient, when invested, to carry the estimated cost of all claims to maturity, to meet the reasonable expenses of conducting the business of the New Fund, and to maintain an excess of surplus over the amount produced by the National Association of Insurance Commissioners' risk-based capital requirements for a casualty insurer. The Old Fund costs are currently funded by investment earnings. The investments of the Montana State Fund are managed by the Montana Board of Investments and invested according to policies established in law. Prior to January 1, 1999, the Old Fund costs were also funded by the Old Fund Liability Tax. The New Fund also paid approximately $102.3 million to the Old Fund during fiscal year 1996-97 as a dividend to defease payroll tax bonds and $63.8 million during fiscal year 1997-98 in accordance with the provisions of section 39-71-2316(2), MCA.

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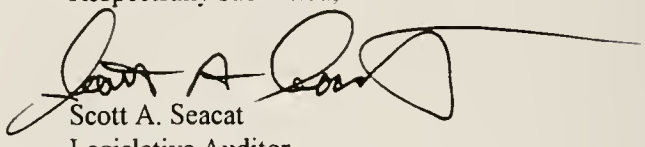
On page A-1, you will find the Independent Auditor's Report followed by the financial statements and accompanying notes. We issued an unqualified opinion which means the reader can rely on the presented information. Montana State Fund's response to our audit is on page B-1.

We thank the Montana State Fund staff for their cooperation and assistance during the audit.

Respectfully submitted,



Scott A. Seacat
Legislative Auditor

Montana State Fund	Carl Swanson	President/CEO
	Mark Barry	Senior Vice President, Administration and Finance
	Jim McCluskey	Vice President, Claims
	Lanny Hubbard	Vice President, Underwriting and Marketing
	Nancy Butler	Vice President, Legal
	Joanne Shydian	Vice President, Human Resources and Communications
	Connie Brooks	Vice President, Information Technology

State Fund Board of Directors

		Term Ending
Jim Brouelette, Chairman	Missoula	4/2001
Brian Donahue	Billings	4/2001
Tom Horn	Cohagen	4/2003
Herb Leuprecht	Butte	4/2001
Lorretta Lynde	Helena	4/2003
Jack Morgenstern	Lewistown	4/2001
Laurie Shadoan*	Bozeman	4/1999

* Appointment of a new member is pending.

For additional information concerning the Montana State Fund contact Carl Swanson, President/CEO, at:

5 South Last Chance Gulch
Helena MT 59601
(406) 444-6501

Members of the audit staff involved in this audit were Pearl M. Allen, Brandon Erickson, and Wayne Kedish.

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Scott A. Seacat, Legislative Auditor
John W. Northey, Legal Counsel
Tori Hunthausen, IT & Operations Manager

Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
James Gillett, Financial-Compliance Audit

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Balance Sheets, New Fund and Old Fund, of the Montana State Fund, a component unit of the state of Montana, as of June 30, 1999 and 1998 and the related Statements of Operations and Changes in Fund Equity, New Fund and Old Fund, and Statements of Cash Flows, New Fund and Old Fund, for each of the fiscal years then ended. The information contained in these financial statements is the responsibility of the Montana State Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Montana State Fund as of June 30, 1999 and 1998, and the results of its operations and of its cash flows for the two fiscal years then ended, in conformity with generally accepted accounting principles.

Respectfully submitted,

James Gillett

James Gillett, CPA
Deputy Legislative Auditor

November 8, 1999

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MONTANA STATE FUND
BALANCE SHEET (with comparison to prior fiscal year end)
The Montana State Fund is a component unit of the State of Montana

NEW FUND	(thousands of dollars) AS OF JUNE 30, 1999	AS OF JUNE 30, 1998
ASSETS		
Cash in Treasury	$446	$1,804
Short-term Investment Pool (Note 1)	25,451	15,326
Premium Receivable (Note 1)	14,995	11,445
Allowance for Doubtful Accounts (Note 1)	(395)	(429)
Due from Other Funds (Notes 1, 5)	1,797	1,650
Interest Receivable (Note 1)	6,494	6,417
Short-term Notes & Loans Receivable	90	28
Long Term Securities (Notes 1, 2)	422,933	427,036
Cash Collateral - Securities on Loan (Note 1)	91,728	98,072
Supplies Inventory	33	42
Equipment (Note 1)	2,575	2,235
Less Accumulated Depreciation	(1,522)	(1,301)
Intangible Assets	6,992	6,944
Property Held in Trust	281	386
Other Assets	479	4
Total Assets	$572,377	$569,659
LIABILITIES AND FUND EQUITY		
Liabilities:		
Estimated Claims Liability (Note 4)	$303,500	$310,687
Liability for Securities on Loan	91,728	98,072
Deferred Revenue	19,315	15,410
Security Deposits (Note 1)	418	462
Accounts Payable	1,417	1,320
Due to Other Funds	10,792	730
Compensated Absences (Note 8)	844	731
Total Liabilities	$428,014	$427,412
Fund Equity:		
Restricted Retained Earnings		$10,000
Unrestricted Retained Earnings	$144,363	132,247
Total Fund Equity	$144,363	$142,247
Total Liabilities and Fund Equity	$572,377	$569,659

The notes are an integral part of the financial statements.

MONTANA STATE FUND
STATEMENT OF OPERATIONS
AND CHANGES IN FUND EQUITY (with comparison to prior fiscal year end)
The Montana State Fund is a component unit of the State of Montana
NEW FUND

	(thousands of dollars) YEAR ENDED JUNE 30, 1999	YEAR ENDED JUNE 30, 1998
UNDERWRITING RESULTS		
Net Premiums	$70,170	$76,421
Claims Expenses:		
Compensation Benefits Paid	28,168	30,263
Medical Benefits Paid	25,486	26,406
Allocated Loss Adjustment Expenses	2,306	2,388
Change in Estimated Claims Liability	(7,187)	(4,420)
Other Expenses:		
Operating Expenses	16,868	11,845
Bad Debts	490	1,199
Underwriting Gain/(Loss)	$4,039	$8,740
Dividend Expense	(9,992)	
Investment Income	29,661	32,481
Net Increase (Decrease) in the Fair Value of Investments (Note 2)	(11,850)	12,488
Securities Lending Income (Note 1)	4,944	5,309
Securities Lending Expense (Note 1)	(4,734)	(5,178)
Other Income	42	36
RESULTS OF OPERATIONS	$12,110	$53,876
Gain on Sale of Fixed Assets	1	
Operating Transfer Out (Note 6)	$10,000	10,000
NET INCOME (LOSS)	$2,111	$43,876
Residual Equity Transfer		(63,800)
Prior Year Adjustment	5	(1,043)
Prior Year End Fund Equity	142,247	163,214
END of PERIOD FUND EQUITY	$144,363	$142,247

The notes are an integral part of the financial statements.

MONTANA STATE FUND
STATEMENT OF CASH FLOWS (with comparison to prior fiscal year end)
The Montana State Fund is a component unit of the State of Montana

NEW FUND	(thousands of dollars) YEAR ENDED JUNE 30, 1999	YEAR ENDED JUNE 30, 1998
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts for Premiums	$69,267	$77,321
Payments to Suppliers for Goods and Services	(6,410)	(3,821)
Payments to Employees	(9,017)	(8,022)
Cash Payments for Claims	(56,307)	(59,081)
Other Operating Revenues	42	36
Other Operating Expenditures	(9,992)	
Net Cash Provided by (Used for) Operating Activities	**($12,417)**	**$6,433**
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Return of Contributed Capital		
Operating Transfer Out		($10,000)
Residual Equity Transfer		(63,800)
Net Cash Provided by (Used for) Noncapital Financing Activities		**($73,800)**
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition of Fixed Assets	($771)	($1,224)
Proceeds from Sale of Fixed Assets	7	2
Net Cash Used for Capital and Related Financing Activities	**($764)**	**($1,222)**
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of Investments	($65,449)	($115,651)
Proceeds from Sales or Maturities of Investments	55,376	138,816
Security Lending Income	5,043	5,290
Security Lending Cost	(4,839)	(5,169)
Interest and Dividends on Investments	31,817	34,243
Net Cash Provided by (Used for) Investing Activities	**$21,948**	**$57,529**
Net Increase (Decrease) in Cash and Cash Equivalents	**$8,767**	**($11,060)**
Cash and Cash Equivalents July 1	**17,130**	**$28,190**
Cash and Cash Equivalents June 30	**$25,897**	**$17,130**

The notes are an integral part of the financial statements.

MONTANA STATE FUND
STATEMENT OF CASH FLOWS (with comparison to prior fiscal year end)
The Montana State Fund is a component unit of the State of Montana

NEW FUND	(thousands of dollars) YEAR ENDED JUNE 30, 1999	YEAR ENDED JUNE 30, 1998
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Results of Operations	**$12,110**	**$53,876**
Adjustments to Reconcile Operating Income to Net Cash Provided by (Used for) Operating Activities		
Depreciation	253	222
Amortization	345	212
Security Lending Income	(4,944)	(5,309)
Security Lending Cost	4,734	5,178
Interest on Investments	(17,811)	(44,969)
Changes in Assets and Liabilities:		
Decr (Incr) in Accounts Receivable	(3,647)	1,995
Decr (Incr) in Due From Other Funds	(142)	208
Decr (Incr) in Inventories	8	7
Decr (Incr) in Other Assets	(369)	110
Incr (Decr) in Accounts Payable	205	445
Incr (Decr) in Due to Other Funds	54	37
Incr (Decr) in Deferred Revenue	3,905	(977)
Incr (Decr) in Property Held in Trust	(44)	(233)
Incr (Decr) in Estimated Claims	(7,187)	(4,420)
Incr (Decr) in Compensated Absences	113	51
Total Adjustments	($24,527)	($47,443)
Net Cash Provided by (Used for) Operating Activities	**($12,417)**	**$6,433**

The notes are an integral part of the financial statements.

MONTANA STATE FUND
The Montana State Fund is a component unit of the State of Montana
BALANCE SHEET (with comparison to prior fiscal year end)

OLD FUND

	(thousands of dollars)	
	AS OF June 30, 1999	**AS OF June 30, 1998**
ASSETS		
Cash in Treasury	$159	$407
Short-term Investment Pool (Note 1)	8,511	8,904
Account Receivable (Note 1)	1,451	3,296
Allowance for Doubtful Accounts (Note 1)	(282)	(258)
Due from Other Funds (Note 1)	430	517
Interest Receivable (Note 1)	1,643	1,479
Long Term Securities (Notes 1, 2)	133,241	111,410
Cash Collateral - Securities on Loan (Note 1)	6,462	596
Other Assets	124	
Total Assets	$151,739	$126,351
LIABILITIES AND FUND EQUITY		
Liabilities		
Estimated Claims Liability (Discounted) (Note 4)	$130,064	$194,401
Liability for Securities on Loan	6,462	596
Deferred Revenue	434	258
Due to Other Funds (Note 5)	289	1,639
Other Liabilities	113	42
Total Liabilities	$137,362	$196,936
Fund Equity		
Contributed Capital	$154,468	$154,468
Unrestricted Retained Earnings	(140,091)	(225,053)
Total Fund Equity	$14,377	($70,585)
Total Liabilities and Fund Equity	$151,739	$126,351

The notes are an integral part of the financial statements

MONTANA STATE FUND
The Montana State Fund is a component unit of the State of Montana
STATEMENT OF OPERATIONS
AND CHANGES IN FUND EQUITY (with comparison to prior fiscal year end)

OLD FUND	(thousands of dollars) YEAR ENDED June 30, 1999	YEAR ENDED June 30, 1998
UNDERWRITING RESULTS		
Premium	($87)	$0
Claims Expenses:		
Compensation Benefits Paid	6,734	8,289
Medical Benefits Paid	5,953	5,755
Allocated Loss Adjustment Expenses	336	580
Change in Actuarially Estimated Claims (Discounted)	(64,337)	(11,277)
Other Expenses		
Administrative Expenses	1,109	2,252
Underwriting Gain/(Loss)	$50,118	($5,599)
Old Fund Liability Tax Revenue	28,891	51,963
Investment Income	8,300	2,265
Net Increase (Decrease) in the FairValue of Investments	(2,367)	169
Security Lending Income (Note 1)	332	36
Security Lending Expense (Note 1)	(312)	(35)
Interest Expense		(2)
NET INCOME	$84,962	$48,797
Capital Contribution - New Fund		63,800
PRIOR YEAR END FUND EQUITY	(70,585)	(183,182)
END of PERIOD FUND EQUITY	$14,377	($70,585)

The notes are an integral part of the financial statements

MONTANA STATE FUND

The Montana State Fund is a component unit of the State of Montana

Statement of Cash Flows (with comparison to prior fiscal year end)

	(thousands of dollars)	
	YEAR ENDED June 30, 1999	**YEAR ENDED June 30, 1998**
OLD FUND		
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts for Sales and Services	($17)	$0
Payments to Suppliers for Goods and Services	(2,440)	($1,674)
Payments to Employees	(190)	(790)
Cash Payments for Claims	(12,990)	(14,584)
Collections of Notes Receivable	2	32
Other operating revenues	31,003	51,849
Net Cash Provided by (Used for) Operating Activities	**$15,368**	**$34,833**
Cash Flows from Noncapital Financing Activities:		
Payment of Principal and Interest on Bonds and Notes		($2)
Contributed Capital from New Fund		63,800
Residual Equity Transfer - New Fund		
Loss on Debt Extinguishment		
Net Cash Provided by (Used for) NonCapital Financing Activities		**$63,798**
Cash Flows from Investing Activities:		
Purchase of Investments	($53,560)	($113,545)
Proceeds from Sales or Maturities of Investments	29,299	2,290
Securities Lending Income	301	36
Securities Lending Expense	(283)	(35)
Arbitrage Rebate Tax		(156)
Interest and Dividends on Investments	8,234	802
Net cash Provided by (Used for) Investment Activities	**($16,009)**	**($110,608)**
Net Increase (Decrease) in Cash and Cash Equivalents	**($641)**	**($11,977)**
Cash and Cash Equivalents, July 1	**9,311**	**21,288**
Cash and Cash Equivalents,June 30	**$8,670**	**$9,311**

The notes are an integral part of the financial statements

MONTANA STATE FUND
The Montana State Fund is a component unit of the State of Montana
Statement of Cash Flow (with comparison to prior fiscal year end)

Reconciliation of Operating Income to Net Cash Provided by Operating Activities:

Old Fund	(thousands of dollars) YEAR ENDED June 30, 1999	YEAR ENDED June 30, 1998
Operating Income (Loss)	**$84,962**	**$48,797**
Adjustments to Reconcile Operating Income to Net Cash Provided by (Used for) Operating Activities:		
Interest Expense		$2
Interest on Investments	(5,933)	(2,434)
Securities Lending Expense	312	35
Securities Lending Income	(332)	(36)
Arbitrage Rebate Tax		156
Change in Assets and Liabilities:		
Decr (Incr) in Accounts Receivable	1,869	285
Decr (Incr) in Due From Other Funds	88	(307)
Decr (Incr) in Other Assets	(124)	
Incr (Decr) in Accounts Payable	18	(9)
Incr (Decr) in Due to Other Funds	(1,356)	(188)
Incr (Decr) in Deferred Revenue	176	(42)
Incr (Decr) in Arbitrage Rebate Tax Payable		(156)
Incr (Decr) in Estimated Claims	(64,337)	(11,277)
Incr (Decr) in Other Liabilities	25	7
Total Adjustments	($69,594)	($13,964)
Net cash provided by (Used for) Operating Activities	**$15,368**	**$34,833**

The notes are an integral part of the financial statements

1. Summary of Significant Accounting Policies

Description of Business

The Montana State Fund (State Fund) is a nonprofit, independent public corporation established under Title 39, Chapter 71 of the Montana Code Annotated (MCA). The State Fund provides Montana employers with an option for workers' compensation and occupational disease insurance and guarantees available coverage for all employers in Montana. The State Fund is governed by a seven member Board of Directors appointed by the Governor. The State Fund is attached to the State of Montana, Department of Administration for administrative purposes only.

During the 1990 Montana Special Legislative Session, legislation passed establishing separate funding and accounts for claims of injuries resulting from accidents occurring before July 1, 1990, referred to as the Old Fund, and claims occurring on or after July 1, 1990, referred to as the New Fund.

The New Fund functions as an autonomous insurance entity supported solely from its own revenues. All assets, debts, and obligations of the New Fund are separate and distinct from assets, debts, and obligations of the State of Montana. Upon dissolution of the New Fund, any monies not needed to liquidate the New Fund would be subject to legislative provision according to state law (Section 39-71-2322, MCA). The State Fund administers and manages the claims remaining in the Old Fund for the State of Montana and is the administering entity for recording the financial activity related to receipt and disbursement of an Old Fund Liability Tax (see note 4, Old Fund). No State general fund money is used for State Fund operations.

Because of the Governor's appointment of the board members and the state's regulatory oversight function, the State Fund financial statements are presented as a component unit in the State of Montana Comprehensive Annual Financial Report.

Basis of Accounting

The State Fund uses the accrual basis of accounting, as defined by generally accepted accounting principles, for its workers' compensation insurance operations. Under the accrual basis, the State Fund records revenues in the accounting period earned, if measurable, and records expenses in the period incurred, if measurable.

Cash and Short Term Investment Pool

Cash balances include demand deposits with the State Treasury. The State Fund also participates in the Montana Board of Investments Short Term Investment Pool (STIP). STIP balances are highly liquid

investments with maturities of 397 days or less. There are no legal risks that the Board of Investments is aware of regarding any STIP investments. The market value of STIP approximates cost. The New Fund STIP balance of $25,450,599 as of June 30, 1999 represented 2.02% of the total STIP. The Old Fund STIP balance of $8,511,322 as of June 30, 1999 represented 0.67% of the total STIP. The New Fund STIP balance of $15,326,427 as of June 30, 1998 represented 1.4% of the total STIP. The Old Fund STIP balance of $8,903,742 as of June 30, 1998 represented 0.8% of the total STIP.

The STIP investments' credit risk is measured by investment grade ratings given individual securities. The Board of Investment's policy requires that STIP investments have the highest rating in the short-term category by one and/or any Nationally Recognized Statistical Rating Organizations (NRSRO). The six NRSRO's include Standard and Poors, Moody's, Duff and Phelps, Fitch, International Bank Credit Agency and Thompson's Bank Watch.

Asset-backed securities constituted 21.64% of the Board of Investment's total STIP portfolio as of June 30, 1999. Asset-backed securities have less credit risk than do securities not backed by pledged assets. Market risk for asset-backed securities is the same as market risk for similar non asset-backed securities. Asset-backed securities constituted 40.4% of the Board of Investment's total STIP portfolio as of June 30, 1998.

Variable rate (Floating Rate) securities made up 26.64% of the Board of Investment's total STIP portfolio as of June 30, 1999. Variable rate securities made up 28.4% of the Board of Investment's total STIP portfolio as of June 30, 1998. While variable rate securities have credit risk identical to similar fixed rate securities, their market risk (income) is more sensitive to interest rate changes. However, the market risk (value/price) may be less volatile than fixed rate securities because their value will usually remain at or near par as a result of their interest rates being periodically reset to maintain a current market yield.

Long Term Securities

The State Fund invests monies with the Montana Board of Investments, including STIP amounts. Securities are stated at fair value as defined and required by Governmental Accounting Standards Board (GASB) Statement Number 31, "Accounting and Financial Reporting for Certain Investments and for External Investment Pools" (GASB 31). Premiums and discounts are amortized using the straight-line method over the life of the securities. Net unrealized gains or losses on securities are included in net income in accordance with GASB 31.

State Fund investments are classified in risk Category 1 or as Not Categorized under State of Montana standards. Risk category 1 includes investments that are insured or registered and held by the Board of Investments or its agent in the Board's name. Not Categorized includes investments held by broker-dealers under loans with cash collateral. Asset-backed securities have less credit risk than do securities not backed by pledged assets. Market risk for asset-backed securities is the same as market risk for similar non asset-backed securities.

Under the provisions of state statutes, the State Board of Investments has, by a Securities Lending Authorization Agreement, authorized the custodial bank to lend the Board's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. State Street Bank was appointed the Board's custodial bank on December 1, 1993. During the

period the securities are on loan, the Board receives a fee and the bank must initially receive collateral equal to 102% of the market value of the securities on loan and must maintain collateral equal to not less than one hundred percent of the market value of the loaned security. The Board retains all rights and risks of ownership during the loan period.

During fiscal years 1998-99 and 1997-98, State Street loaned, on behalf of the Board, certain securities held by State Street, as custodian, and received U.S. dollar currency cash, U.S. Government securities, and irrevocable bank letters of credit. State Street does not have the ability to pledge or sell collateral securities unless the borrower defaults.

The Board did not impose any restrictions during fiscal years 1999 and 1998 on the amount of the loans that State Street made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during fiscal years 1999 and 1998. There were no losses during fiscal years 1999 and 1998 resulting from default of the borrowers or State Street.

During fiscal years 1998-99 and 1997-98, the Board of Investments and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified plan lenders, in a collective investment pool, the Securities Lending Quality trust. The relationship between the average maturities of the investment pool and the Board's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which the Board could not determine. On June 30, 1999 and June 30, 1998, the Board had no credit risk exposure to borrowers.

The following table presents the carrying and market values of the securities on loan and the total collateral held for fiscal years 1998-99 and 1997-98 for both the New Fund and the Old Fund:

	NEW FUND Fiscal Year 1998-99	NEW FUND Fiscal Year 1997-98	OLD FUND Fiscal Year 1998-99	OLD FUND Fiscal Year 1997-98
Securities on Loan-Book Value	$83,897,929	$96,399,897	$5,789,105	$0
Securities on Loan-Market Value	$87,466,456	$102,345,909	$5,833,184	$0
Total Collateral Held	$91,728,271	$107,454,766	$6,462,317	$596,292

As of June 30, 1999, investments in the New Fund and the Old Fund include $83,897,929 (approximately 19.8% of total long-term securities), and $5,789,105 (approximately 4.3% of total long-term securities), respectively, in long term securities on loan which earned interest income during the fiscal year of $4,943,583 and $332,198, respectively. As of June 30, 1998, investments in the New Fund and the Old Fund include $96,399,897 (approximately 22.6% of total long-term securities), and $0, respectively, in long term securities on loan which earned interest income during the fiscal year of $5,308,940 and, $36,387 respectively. Securities on loan are classified as risk category 1 or are not categorized.
Montana's Constitution does not currently allow the State Fund to invest in equity securities.

Receivables
The New Fund premium receivable balance of $14.995 million at June 30, 1999 includes $4.4 million of premium due from insureds for insurance coverage provided during fiscal year 1998-99 not yet

received. The remaining $10.5 million represents advance premiums billed but not received for insurance coverage effective July 1, 1999 as part of the State Fund's Premium in Advance program. This amount is offset in deferred revenue. Estimated uncollectible receivables are reported as an allowance for doubtful accounts of $394,476. Other receivables include $6.4 million in investment income due, and $1.9 million due from other state agencies and funds.

The New Fund premium receivable balance of $11.4 million at June 30, 1998 included $4.2 million of premium due from insureds for insurance coverage provided during fiscal year 1997-98 not yet received. The remaining $7.2 million represented advance premiums billed but not received for insurance coverage effective July 1, 1998 as part of the State Fund's Premium in Advance program. This amount is offset in deferred revenue. Estimated uncollectible receivables are reported as an allowance for doubtful accounts of $428,546. Other receivables include $6.4 million in investment income due, and $1.6 million due from the Old Fund in administrative cost reimbursement.

Accounts receivable in the Old Fund includes amounts due from past premiums in dispute or in collection and amounts due from Old Fund Liability Tax collections. Interest receivable of $1.4 million represents investment income due. Estimated uncollectible receivables are reported as an allowance for doubtful accounts.

Fixed Assets
Equipment is capitalized if the actual or estimated historical cost exceeds $5,000.00. Depreciation expense is computed on a straight-line basis for equipment over a period of five to ten years. Amortization of intangible assets is computed on a straight-line basis over a period of three to seven years and is applied directly to the asset balance. All fixed assets are recorded in the New Fund. Because the State Fund administers the Old Fund, the Old Fund does not carry fixed assets.

Advanced Deposits
Security deposits are deposits by certain policyholders that secure payment of premiums.

Deferred Revenue
Deferred revenue reflect amounts in advance that are received or billed, but not yet earned for policies effective July 1, 1999 or July 1, 1998.

Premiums
The State Fund Board of Directors approves premium rates annually. Policies are effective July 1 through June 30 of each fiscal year. Revenue from premiums is recognized over the term of the year.

Policyholders are contractually obligated to pay certain premiums to the State Fund in advance of the period the premiums are earned. Premium advances are refundable when the policyholder's coverage is canceled and all earned premiums have been credited by the State Fund.

Fund Equity
Fund Equity consists of the net excess or deficit of assets over liabilities.

Presentation

The financial statements are presented in accordance with generally accepted accounting principles

as prescribed by the Governmental Accounting Standards Board. State Fund insurance operations are classified as an Enterprise Fund, Proprietary Fund type.

The Enterprise Fund of the State Fund is part of, but does not comprise, the entire Enterprise Fund of the State of Montana. The financial statements in this report reflect the financial position and results of operations and cash flows of the Montana State Fund (New Fund and Old Fund), not the State of Montana.

The Enterprise Fund is used to account for operations: (a) financed and operated in a manner similar to private business enterprises, where the legislature intends that the entity finance or recover costs primarily through user charges; or (b) where the legislature has decided that periodic determination of revenues earned, expenses incurred, or net income is appropriate.

According to GASB Statement No. 31, Accounting and Financial Reporting for Certain Investments and External Investment Pools, STIP is considered an external investment pool. An external investment pool is defined as an arrangement that pools the monies of more than one legally separate entity and invests, on the participant's behalf, in an investment portfolio. STIP is also classified as a "2a7-like" pool. A 2a7-like pool is an external investment pool that is not registered with the Securities and Exchange Commission (SEC) as an investment company, but has a policy that it will, and does, operate in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940. If certain conditions are met, 2a7-like pools are allowed to use amortized cost rather than fair value to report net assets to compute unit values. The Board of Investments has adopted a policy to treat STIP as a 2a7-like pool.

As a governmental entity, the State Fund is required to follow rules promulgated by the Governmental Accounting Standards Board. A private insurance carrier reporting under GAAP accounting rules would follow Financial Accounting Standards Board statement 115 (FASB 115) as their guideline in reporting changes in market values of investments held to maturity. The State Fund holds its investments to maturity and as such followed FASB 115 prior to the implementation of GASB 31.

A comparison of the GASB 31 and FASB 115 treatments on the New Fund financial statements for fiscal year 1998-99, under a held-to-maturity classification of investments, reveals:

	GASB 31	FASB 115
Underwriting Gain/Loss	$4,038,951	$4,038,951
FY 99 Market Valuation Effect	(12,429,107)	
Other Investment Income	30,449,824	30,449,824
Dividend Expense	(9,992,186	(9,992,186)
Operating Transfers Out	(10,000,000)	(10,000,000)
Other Income/(Expense)	43,993	43,993
Net Income	$2,111,475	$14,540,582
Beginning Surplus	142,246,745	127,231,220
Prior Year Adjustment	5,013	5,013
Ending Surplus 6/30/99	$144,363,233	$141,776,815

See Note 2 for further discussion of the effect of GASB 31.

2. Investments

The amortized cost and market value of the New Fund fixed maturity securities as of June 30, 1999, and June 30, 1998, are as follows:

June 30, 1999	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Loss	Market Value
U. S. Treasury Securities	$ 91,926,186	$ 3,756,754	$ 0	$ 95,682,940
U. S. Governmental Agencies And U. S. Government Guaranteed Securities	$ 57,435,349	$ 413,175	$ 1,095,049	$ 56,753,475
Corporate Securities Asset-Backed	$ 54,346,938	$ 311,625	$ 319,394	$ 54,339,169
Other Corporate Securities	$ 205,637,445	$ 2,678,518	$ 3,225,832	$ 205,090,131
Other Securities	$ 11,000,850	$ 84,034	$ 17,414	$ 11,067,470
STIP	$ 25,450,599	$ 0	$ 0	$ 25,450,599
Totals	**$ 445,797,367**	**$ 7,244,106**	**$ 4,657,689**	**$ 448,383,784**

June 30, 1998	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Loss	Market Value
US Treasury Securities	$92,502,708	$5,849,312	$0	$98,352,020
US Government Agencies and US Government Guaranteed Securities	$41,923,567	$1,054,294	$43,046	$42,934,815
Corporate Securities Asset Backed	$67,636,219	$598,229	$3,935	$68,230,513
Other Corporate Securities	$198,958,334	$7,221,862	$85,038	$206,095,158
Other Securities	$10,999,673	$424,089	$242	$11,423,520
STIP	$15,326,427	$0	$0	$15,326,427
Totals	**$427,346,928**	**$15,147,786**	**$132,261**	**$442,362,453**

The amortized cost and estimated market value of the New Fund's fixed maturity securities as of June 30, 1999 and June 30, 1998, are shown below at contractual maturity. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Market Value
June 30, 1999		
Due one year or less	$ 35,449,536	$ 35,527,599
Due after one year through five years	172,447,998	174,386,666
Due after five years through ten years	185,305,816	187,854,025
Due after ten years	52,594,017	50,615,494
Totals	$445,797,367	$448,383,784
June 30, 1998		
Due one year or less	$ 25,458,153	$ 25,466,273
Due after one year through five years	158,054,481	161,724,116
Due after five years through ten years	214,337,241	224,690,001
Due after ten years	29,497,054	30,482,063
Totals	$427,346,928	$442,362,453

During fiscal year ending June 30, 1999, the New Fund realized gross gains from sales of securities of $601,763 and gross realized losses of $22,729. During fiscal year ending June 30, 1998, the New Fund realized gross gains from sales of securities of $1,302,709 and gross realized losses of $41,776.

As discussed in Note 1, GASB 31 requires governmental entities to state their investments at fair value. Fair value is defined as the amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The adjustment to fair value is reflected as an increase or decrease in investment income. During fiscal year 1998-99, investment income for the New Fund was adjusted downward $12.4 million due to the unrealized loss on long term investments. Investment income for fiscal year 1997-98 was increased $11.3 million for the unrealized gain which occurred during that year on long term investments.

The amortized cost and market value of the Old Fund fixed maturity securities as of June 30, 1999, and June 30, 1998, are as follows:

June 30, 1999	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Loss	Market Value
U. S. Treasury Securities	$5,076,095	$53,605	$0	$5,129,700
U. S. Governmental Agencies And U. S. Government Guaranteed Securities	$44,858,131	$0	$973,688	$43,884,443
Corporate Securities Asset-Backed	$40,080,638	$30,169	$329,086	$39,781,721
Other Corporate Securities	$43,456,686	$19,115	$1,017,596	$42,458,205
Other Securities	$1,996,884	$0	$10,444	$1,986,440
STIP	$8,511,322	$0	$0	$8,511,322
Totals	**$143,979,756**	**$102,889**	**$2,330,814**	**$141,751,831**

June 30, 1998	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
U. S. Treasury Securities	$0	$0	$0	$0
U. S. Governmental Agencies And U. S. Government Guaranteed Securities	$40,212,956	$157,944	$71,874	$40,299,026
Government Mortgage-Backed	$11,994,040	$21,226	$24,939	$11,990,327
Corporate Securities Asset-Backed	$30,353,653	$39,601	$1,330	$30,391,924
Other Corporate Securities	$26,684,171	$100,234	$60,821	$26,723,584
Other Securities	$1,996,036	$8,624	$0	$2,004,660
STIP	$8,903,742	$0	$0	$8,903,742
Totals	**$120,144,598**	**$327,629**	**$158,964**	**$120,313,263**

The amortized cost and estimated market value of the Old Fund's fixed maturity securities as of June 30, 1999 are shown below at contractual maturity. Expected maturities will differ from contractual maturities

because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

June 30, 1999	Amortized Cost	Estimated Market Value
Due one year or less	$10,514,620	$10,515,042
Due after one year through five years	$56,795,902	$56,272,970
Due after five years through ten years	$46,022,894	$45,204,499
Due after ten years	$30,646,339	$29,759,320
Totals	**$143,979,755**	**$141,751,831**

June 30, 1998	Amortized Cost	Estimated Market Value
Due one year or less	$10,920,127	$10,921,482
Due after one year through five years	$46,174,229	$46,317,956
Due after five years through ten years	$56,271,243	$56,319,765
Due after ten years	$6,779,000	$6,754,060
Totals	**$120,144,599**	**$120,313,263**

During fiscal year 1998-99, investment income for the Old Fund was decreased $2,396,589 due to the unrealized loss on its long-term portfolio. During fiscal year 1997-98, the effect of GASB 31 on Old Fund investment income was an increase of $168,665.

During fiscal year ending June 30, 1999, the Old Fund realized $30,392 in gross gains from sales of securities and no gross realized losses. During fiscal year ending June 30, 1998, the Old Fund realized $1,728 in gross gains from sales of securities and no gross realized losses.

3. Reinsurance

For the two fiscal years ended June 30, 1999 the State Fund ceded reinsurance to other insurance companies to limit the exposure arising from large losses. These arrangements consist of excess of loss contracts that protect against losses over stipulated amounts. During fiscal years 1997-98 and 1998-99, the State Fund retained the first $1.5 million of each loss and $500,000 in aggregate annual deductible while reinsurers were liable for losses in excess of $2 million up to a limit of $50 million on occurrences involving multiple claimants. Individual, per person coverage was provided up to $5 million per claimant with the State Fund retaining the first $2.5 million. This per person coverage is subject to an annual limit of $10 million. In the event, reinsurers are unable to meet their obligations; the State Fund would remain liable for all losses, as the reinsurance agreements do not discharge the State Fund from its primary liability

to the policyholders.

Effective March 31, 1998 the State Fund purchased reinsurance coverage for Employers' Liability insurance offered to policyholders during fiscal years 1997-98 and 1998-99. This coverage extended to August 1, 1999 and has been renewed for the period August 1, 1999 through August 1, 2000. The State Fund will retain the first $200,000 in ultimate net loss for any one occurrence while reinsurers are liable for losses in excess of $200,000 up to a limit of $1,000,000. The reinsurance coverage provides for two full reinstatements of coverage at no additional cost, which, in total, provides $2,400,000 in ultimate net loss coverage for all occurrences during the contract period.

Effective January 1, 1999 the State Fund purchased reinsurance coverage for Out of State insurance offered to policyholders effective January 1, 1999. The coverage extends to January 1, 2000. The State Fund will retain the first $250,000 in ultimate net loss for each loss occurrence while the reinsurers are liable for losses in excess if $250,000 up to a limit of $5,000,000.

Premium revenue is reduced by premiums paid for reinsurance coverage of $259,498 and $311,902 in fiscal years 1998-99 and 1997-98, respectively.

During fiscal year 1998-99, estimated claim reserves were reduced $15 million for the amount of reinsurance estimated to be ultimately recoverable on incurred losses. Reinsurance had no effect on the financial results of fiscal year 1997-98.

4. Risk Management/Public Entity Risk Pool

The Old and New Funds are public entity risk pools. Neither fund had significant reductions in insurance coverage from the prior year, nor any insurance settlements exceeding insurance coverage. Unpaid claims and claims adjustment expenses are estimated based on the ultimate cost of settling the claims including the effects of inflation and other socioeconomic factors.

The New Fund provides liability coverage to employers for injured employees that are insured under the Workers' Compensation and Occupational Disease Acts of Montana. Workers' compensation claims occurring on or after July 1, 1990, are reported in the New Fund. The New Fund must insure any employer who desires coverage. At June 30, 1999, approximately 23,269 employers were insured by the New Fund. At June 30, 1998, approximately 24,043 employers were insured with the New Fund. Anticipated investment income is considered when computing premium rate levels and employers must pay premiums to the State Fund within specified time frames.

Tillinghast-Towers Perrin prepared an actuarial study and estimated liabilities and the ultimate cost of settling claims reported but not settled and claims incurred but not reported for the New Fund as of June 30, 1999 and June 30, 1998. Because actual claim costs depend on such complex factors as inflation and changes in the law, claim liabilities are recomputed periodically using a variety of actuarial and statistical techniques to produce current estimates that reflect recent settlements, claim frequency, and other economic and social factors.

A provision for inflation and the calculation of estimated future claim costs is implicit in the calculation because reliance is placed both on actual historical data that reflect past inflation and on other factors that are considered to be appropriate modifiers of past experience. As of June 30, 1999, $303,500,030 of

unpaid claims and claim adjustment expenses are presented at face value net of estimated reinsurance recoverable. As of June 30, 1998, $310,687,327 of unpaid claims and claim adjustment expenses are presented at face value. When the New Fund purchases annuity contracts, the claim is settled in full and on a final basis, and all liability of the New Fund is terminated.

State law requires the New Fund to set premiums at least annually at a level sufficient to ensure adequate funding of the insurance program during the period the rates will be in effect. State law also requires the Board of Directors to annually determine the level of surplus that must be maintained by the State Fund with at least a minimum surplus balance of 25% of annual premium revenue. The State Fund shall use the amount of the surplus above the risk based capital requirements to secure the state fund against various risks inherent in or affecting the business of insurance and not accounted for or only partially measured by the risk based capital requirements.

The Old Fund covers the liability and payment of workers' compensation claims for incidents occurring before July 1, 1990. Funding for claims payments is provided by Old Fund Liability Taxes (OFLT) imposed on employer payroll (0.5%), employee wages (0.2%), and sole proprietor and subchapter S shareholder distributive income (0.2%). The OFLT provides funding for Old Fund claim expenses and Old Fund bond payments (see notes 5,7 and 12).

An actuarial study prepared by Tillinghast-Towers Perrin for the Old Fund as of June 30, 1999, was used to estimate liabilities and the ultimate cost of settling claims that have been reported, but not settled and claims that have been incurred, but not reported. As of June 30, 1999, $185,064,668 of unpaid claims and unpaid claim adjustment expenses are presented at their net present value of $130,063,841, discounted at a 5.5% rate. As of June 30, 1998, $194,401,217 of unpaid claims and claim adjustment expenses are presented at face value. Total Old Fund surplus as of June 30, 1999 is $14,376,735 compared to a deficit of $70,585,411 as of June 30, 1998.

Changes in Claims Liabilities for the Past Two Years

The following table presents changes (in thousands) in the aggregate liabilities for the New Fund and the Old Fund for the past two years net of estimated reinsurance recoverable. The information presented has not been discounted.

	New Fund		Old Fund	
	1999	1998	1999	1998
Unpaid claims and claim adjustment expenses at beginning of year	$310,687	$344,632	$194,401	$205,678
Incurred claims and claim adjustment expenses:				
Provision for insured events of the current year	69,390	69,277		
Increases (decreases) in provision for events of prior years	(15,791)	(44,165)	3,686	3,347
Total incurred claims and claim adjustment expenses	53,599	25,112	3,686	3,347
Payments:				
Claims and claim adjustment expenses attributable to insured events of the current year	(14,878)	(12,942)		
Claims and claim adjustment expenses attributable to insured events of prior years	(45,908)	(46,115)	(13,023)	(14,624)
Total Payment	**(60,786)**	**(59,057)**	**(13,023)**	**(14,624)**
Total unpaid claims and claim adjustment expenses at end of the year	**$303,500**	**$310,687**	**$185,064**	**$194,401**

Risk Management Trend Information

The following table illustrates (in thousands) how the earned revenues of the New Fund plus investment income compare to related costs of losses and other expenses assumed by the State Fund for fiscal years 1991 through 1999. In addition, cumulative amounts related to estimated and actual paid claims are presented. The information allows for comparison of actual and estimated claims and is a basis for developing revenue and claims information. As data for individual policy years mature, the correlation between original estimates and re-estimated amounts is used to evaluate the accuracy of incurred claims currently recognized for less mature policy years.

New Fund

	1991	1992	1993	1994	1995	1996	1997	1998	1999
1. Premiums and Investment Revenue									
Earned	$117,215	$157,741	$207,290	$223,309	$184,149	$129,081	$97,476	$81,823	$68,945
Ceded	231	270	289	318	269	519	348	303	260
Net Earned	$116,984	$157,471	$207,001	$222,991	$183,880	$128562	$97,128	$81520	$68,685
2. Unallocated expenses including overhead	9,853	11,697	13,177	14,234	15,701	18,640	14,051	16,182	21,786
3. Estimated losses and expenses, end of accident year									
Incurred	$133,819	$183,425	$186,480	$199,890	$164,628	$95,067	$76,067	$64,983	$64,645
Ceded	0	0	0	0	0	0	0	0	838
Net Incurred	$133,819	$183,425	$186,480	$199,890	$164,628	$95,067	$76,067	$64,983	$63,807
4. Net paid (cumulative) as of:									
End of policy year	17,618	20,244	18,347	18,693	18,137	15,818	12,589	12,943	13,723
One year later	44,335	50,576	46,343	45,947	40,473	32,890	28,451	28,222	
Two years later	64,079	68,837	62,717	60,971	52,073	42,361	35,706		
Three years later	74,901	77,950	71,666	67,576	58,722	47,283			
Four years later	81,747	83,173	76,280	72,212	62,419				
Five years later	85,924	86,461	80,165	75,799					
Six years later	88,532	89,370	82,981						
Seven years later	91,235	91,902							
Eight Years Later	93,381								
5. Re-estimated ceded losses and expenses	0	0	1,967	2,283	0	2,471	7,439	1	838
6. Re-estimated net incurred losses and expense:									
End of policy year	$133,819	$183,425	$186,480	$199,890	$164,628	95,067	76,067	64,983	63,807
One year later	166,980	184,968	184,030	184,920	124,123	88,923	67,235	64,308	
Two years later	160,272	175,218	167,052	135,472	107,074	77,286	59,054		
Three years later	151,554	161,184	133,017	116,756	95,456	73,864			
Four years later	141,389	135,775	120,583	107,656	94,517				
Five years later	130,250	125,084	111,208	105,052					
Six years later	121,568	119,780	109,415						
Seven years later	118,856	120,472							
Eight Years Later	118,948								
7. Increase (decrease) in estimated net incurred losses and expenses from end of policy year	(14,871)	(62,953)	(77,065)	(94,838)	(70,111)	(21,203)	(17,013)	(675)	

5. Administrative Cost Allocation

State law requires the State Fund to separately determine and account for administrative expenses and benefit payments for claims for injuries resulting from accidents occurring before July 1, 1990 (Old Fund) from those occurring on or after July 1, 1990 (New Fund). The law also limits annual administrative costs of claims associated with the Old Fund to $1.25 million for Fiscal year 1998-99 and $3 million for fiscal year 1997-98. The State Fund allocated $1.25 million and $2.396 million in administration costs to the Old Fund in fiscal years 1998-99 and 1997-98, respectively. The Old Fund has a $428,770 obligation to the New Fund in unrecovered administrative costs incurred in fiscal year 1998-99. The New Fund intends to recover this amount in future years where the cost of administering the Old Fund is less than the statutorily permitted $1.25 million.

6. New Fund Surplus Distributions

i. Dividend Paid to Policyholders

During Fiscal Year 1998-99, the State Fund Board of Directors authorized a dividend be paid to policyholders of record during fiscal year 1997. The dividend payment was not to exceed $10 million in aggregate as recommended by the consulting actuary, Tillinghast-Towers Perrin.

Payment of the dividend totaling $10 million was accomplished during January 1999.

ii. Payment to State General Fund

Section 39-71-2320 (2) MCA provides for the payment of $10 million by the New Fund to the State's General Fund in each of the fiscal years ending June 30, 1998 and June 30,1999. When completed, this will repay in full the $20 million appropriation made to the Old Fund during the June 1989 Special Legislative Session in lieu of a 22% rate increase originally planned at that time.

Payments were accomplished in fiscal years ending June 30, 1999 and June 30, 1998 of $10 million each. Both are reflected in the financial statements as an operating transfer out.

7. Old Fund Surplus Position

The Budget Director determined, based on the recommendation presented by the State Fund Board of Directors in September 1998, that the Old Fund Liability Tax could end on January 1, 1999 in compliance with State law.

Because the Old Fund was determined to be adequately funded as of December 31, 1998, the Old Fund Liability Tax was terminated and a process was put in place to measure the status of the Old Fund's surplus level annually on a present value basis using a discount factor of 5.5% to determine compliance with state law requirements for maintaining fund adequacy.

State law defines the term "adequately funded" to mean the present value of:

a) the total cost of future benefits remaining to be paid; and,
b) the cost of administering the claims; and,
c) an amount equal to 10% of the total of the amounts in subsections (a) and (b) above.

As of June 30, 1999 the Old Fund surplus level using a present value discount factor of 5.5% was $14,376,735. The 10% contingency required to be retained in excess of the full cost needed to cover the expense of the administration and payment of any unpaid claims equaled $13,006,384.

8. Compensated Absences

Employees at the State Fund accumulate both annual leave and sick leave. The State Fund pays employees for 100% of unused annual leave and 25% of unused sick leave upon termination. The fund pays 100% of unused compensatory leave credits upon termination to nonexempt employees. The State Fund absorbs expenditures for termination pay in its annual operational costs. The State Fund had a total leave liability of $907,249 and $768,172 at June 30, 1999, and June 30, 1998, respectively.

9. Pension Plan

The State Fund and its employees contribute to the Public Employees Retirement System (PERS), a mandatory multiple-employer, cost-sharing, defined benefit pension plan administered by the State of Montana Public Employees Retirement Division (PERD). The PERS offers retirement, disability and death benefits to plan members and their beneficiaries. Established in 1945, the plan is governed by Title 19, Chapters 2 and 3, MCA. PERS participants are eligible to retire at age 60 with at least five years of service, at age 65 regardless of length of service or at 30 years of service regardless of age. Actuarially reduced retirement benefits may be taken with 25 years of service or at age 50 with a minimum of five years of service. Monthly retirement benefits are calculated by taking 1/56 times the years of service times the final average salary. Vesting occurs once membership service totals 5 years. The authority to establish and amend contribution rates and to provide cost of living adjustments for the plan is assigned to the State legislature. State Fund and its employees each were required to contribute 6.8% of annual compensation in fiscal years 1998-99 and 1997-98. This amounted to $1,006,516 for fiscal year 1998-99 and $917,989 for fiscal year 1997-98. State Fund and its employees paid one hundred percent of required contributions to PERS and there is no unpaid liability as of June 30, 1999.

The PERS financial information is reported in the Public Employees' Retirement Board *Comprehensive Annual Financial Report* for the fiscal year-end. It is available from the PERD at 1712 Ninth Avenue, P. O. Box 200131, Helena, MT 59620-0131, 406/444-3154.

10. Building

The 1981 Legislature appropriated funds for the construction of a Workers' Compensation building. As of July 1, 1990, the State Fund transferred the value of the building from its records to the Department of Administration, which owns most other state buildings and charges agencies rent for their use. Under the agreement, the State Fund pays all costs associated with the building, including utilities, property taxes, janitorial services, and maintenance in lieu of paying rent.

11. Contingencies

In prior years, the State Fund purchased single premium annuities from Confederation Life Insurance Company (the Company), Atlanta, Georgia to settle claims. The Company has been placed in bankruptcy rehabilitation by the Michigan Insurance Department. State Fund legal counsel has reviewed the rehabilitation plan (Plan) of Confederation Life Insurance Company. There were twelve Old Fund claims with annuities with the Company. The outstanding balances on the annuities amount to $356,755. The Plan anticipates full payment of annuity contracts. State Fund will continue to monitor the execution of the Plan.

Broeker v. State Fund The issue in this case involved the method insurers use to calculate the social security disability insurance (SSDI) offset rates on certain claims. The Workers' Compensation Court decision stated that, where there is a cost of living increase built into the initial entitlement to social security disability benefits, the workers' compensation insurer cannot take the cost of living increase into consideration when computing the SSDI offset rate. On appeal, the Montana Supreme Court affirmed the Workers' Compensation Court decision. This decision affects prior unsettled claims and similarly situated claimants that will receive benefits in the future. Because these claims have not been identified, no calculation of potential benefits due has been made. This matter is currently before the Workers' Compensation Court for implementation of the Supreme Court's decision. The Workers' Compensation Court has requested the Social Security Administration's assistance in identifying affected claims.

Murer, et al. v. Montana State Compensation Mutual Insurance Fund, et al. This case involves the 1987 legislature's limiting of workers' compensation benefits for injuries occurring during the period July 1, 1987 through June 30, 1989. The 1989 legislature reenacted those limits for injuries occurring during the period July 1, 1989 through June 30, 1991.

The Montana Supreme Court found that those limits should have expired on June 30, 1989 for injuries occurring during the period July 1, 1987 through June 30, 1989 and should have expired on June 30, 1991 for injuries occurring during the period July 1, 1989 through June 30, 1991.

The State Fund is finalizing the review of about 7,500 claims to determine qualification for increased benefits due to expiration of the limits instituted by the 1987 and 1989 legislative sessions. Total cost impact is estimated to be between $1 million and $2 million. Individual case loss reserves are adjusted as liability is determined.

Michael Powell vs. State Fund This case involves the constitutionality of 39-71-1107(4), MCA, which places limits on compensation paid to family members providing domiciliary care to claimants. The State Fund prevailed in Workers' Compensation Court with a finding that current law does not violate the claimant's rights to equal protection and privacy. The issue has been appealed to the State Supreme Court. The potential cost impact, if any, has not yet been determined.

12. Year 2000

The year 2000 (Y2K) issue refers to the fact that many computer programs use only the last two digits to refer to a year. Therefore, both 1900 and 2000 will be referred to as "00". Computer programs must be adjusted to recognize the difference between those two years or the programs will fail or create errors. Also, some programs may not be able to recognize that 2000 is a leap year. Further, Y2K could affect electronic equipment, such as environmental systems and elevators, containing computer chips that have date recognition features.

The State Fund has been addressing Y2K issues relating to its computer systems and other electronic equipment for more than two years.

The State Fund established aY2K Project Team to assure that all State Fund systems are Y2K compliant. The main goals of the team are to promote awareness, perform compliance assessment, and develop a compliance plan. The awareness stage - establishing a budget and project plan, and the assessment stage – identifying non-compliant Y2K systems and components - have been completed.

The State Fund identified the PowerComp™ system, including hardware, software, firmware and application systems, which were date sensitive. This system was categorized according to the level of disruption that could result if the system failed. This categorization resulted in the components of this system being considered "mission critical" or high priority, medium priority and low priority. A plan was developed for the whole system detailing how the problem will be addressed (repair, replace or retire); as well as a target date to have the system compliant.

The State Fund's mission critical systems are considered Y2K compliant.

The State of Montana is implementing a new accounting system and updating or replacing other financial systems. In fiscal year 1998, bonds which are recorded in the financial records were issued to purchase replacement systems or update current systems.

The State Fund's commitment for this debt in FY2000 is $51,527. For the total bond commitment see the State of Montana's Comprehensive Annual Financial Report (CAFR).

Because of the unprecedented nature of the Y2K issue, its effects and the success of related remediation efforts will not be fully determinable until the year 2000 and thereafter. Management cannot assure that the State Fund is or will be Y2K ready, that the remediation efforts will be successful in whole or in part, or that parties with whom the State Fund does business will be Y2K ready.

STATE FUND MONTANA

STATE COMPENSATION INSURANCE FUND

5 SOUTH LAST CHANCE GULCH
P.O. BOX 4759
HELENA, MONTANA 59604-4759

Customer Service 800-332-6102 or 406-444-6500

Carl W. Swanson, President

November 30, 1999

DEC - 1 1999

Mr. Scott A. Seacat
Legislative Audit Division
PO Box 201705
Helena, MT 59620-1705

Dear Mr. Seacat:

Montana State Fund thanks the Legislative Audit Division for their review of our operations and financial statements for the year ended June 30, 1999, with comparison to the prior fiscal year. We especially thank the auditors involved in the audit for the unqualified opinion on the financial statements we have presented.

As shown in the statements, the Montana State Fund issued a $10 million dividend to the employers of the State for the first time since 1982. That is 14.3% of the premium of fiscal year 1999. We issued our dividend to our customers after having contributed $166 million of State Fund surplus to assist the state to eliminate the Old Fund Liability Tax in December, 1998 and to fully fund the Old Fund liability. With the strong financial condition of the State Fund at the end of fiscal year 1999, I look forward to recommending another dividend to our Board of Directors before the close of our current fiscal year.

The management and staff of Montana State Fund are very proud of our accomplishments in serving the Montana business community. Our success is the result of the years of support we have received from Montana legislators. We thank our legislators for their support, which has led to our ability to successfully serve Montana employers and their employees.

Sincerely,

Carl Swanson
President/CEO